

## The Challenges of Growth and Employment

**Dennis Lockhart**  
President and Chief Executive Officer  
Federal Reserve Bank of Atlanta

Instituto de Empresas  
Madrid, Spain  
February 12, 2013

### Key points

- Atlanta Fed President and CEO Dennis Lockhart talks to business students at the Instituto de Empresas in Madrid, Spain, about two great problems that U.S. and European policymakers are facing: growth and employment.
- Lockhart does not expect 2013 to be a "breakout" year for the U.S. economy; he forecasts that GDP growth will continue to be sluggish, between 2 and 2 1/2 percent.
- Lockhart believes that part of the solution to the problems of growth and employment include greater entrepreneurship, more new business formation, and more investment in innovation.
- Lockhart thinks that the recent focus among U.S. and European policymakers on the role of young, growth-oriented firms as a major source of employment growth may be misplaced.
- Lockhart says that policymakers must pursue an effective mix of policy elements that together can catalyze a cycle of innovation, growth, and employment.



### Introduction

I'm very pleased to be here in Madrid and at the distinguished Instituto de Empresas. Many thanks to the Ramon Areces Foundation for partnering with IE to organize this event. Many thanks also to Professor Marco Tombetta, Associate Professor Juan-Pedro Gomez, and Isabel Garces Correa at IE for your individual efforts in pulling together many details.

I confess I am biased in favor of IE for two reasons. First, because my daughter got her MBA here in 2010. And second, because IE is known for its educational emphasis on entrepreneurship. Greater entrepreneurship—that is, more new business formation and more investment in innovation is part of the solution to two great problems advanced economies are facing. These problems are growth and employment.

I am out of my natural habitat. In the United States, an audience might be interested in a pretty detailed analysis of U.S. economic challenges and my view of the economic outlook. I might even get away with some discussion of the intricacies of the Fed's monetary policy—the federal funds rate at the zero lower bound, quantitative easing, Fed communication policies, and all that. This evening, I'd like to frame my remarks in a way that's somewhat less U.S.-centric by talking about these two concerns—growth and employment—that are common to both the United States and Spain (and more broadly to much of Europe). I will talk about what's going on in the United States to highlight challenges being faced on both sides of the Atlantic.

I will share with you some thoughts on the prospects for economic growth and the causes of weak growth in the United States. I'll spend some time on the role of early-stage firms in generating employment, a topic that should be of interest here at IE given the entrepreneurship emphasis of the school. I'm going to share some thinking that I admit is a work in process. I'll give you a sense of the evolution of my staff's and my understanding of the role of early-stage entrepreneurial ventures in job creation.

Faster growth and higher employment are complex challenges. The solutions aren't simple or easy. On either side of the Atlantic, progress will depend on a lot of relatively small things getting fixed or done better rather than one big thing.

At this point, let me add a disclaimer. When a Federal Reserve Bank president speaks, he or she is putting forth personal views and is not speaking for the Federal Reserve. Only Federal Reserve governors speak for the Federal Reserve and only Chairman Bernanke speaks for the Federal Open Market Committee. So my remarks will represent my personal views.

Policymakers on both sides of the Atlantic are grappling with the question of how to generate more rapid GDP growth and how to bring down the high rates of unemployment.

In some respects, I prefer thinking about the latter concern in terms of its mirror image—how to generate sufficient employment.

The official unemployment rate in the United States is currently 7.9 percent, considerably below the rate of unemployment here in Spain. That's not a reason for Americans to gloat. The larger employment reality in the United States involves a high rate of underemployment (people working part time who would prefer full time) and low levels of participation in the workforce (discouraged would-be workers who have dropped out of the labor force and are not counted in unemployment).

### Growth outlook in the U.S.

There's an ongoing debate about the extent to which the causes of weak labor markets are structural or cyclical. The cyclical view maintains that the problem is just a deficit of aggregate demand and, with a quicker pace of growth, much of the problem will be solved.

A sense of urgency is appropriate for this goal. If policymakers are too patient, what started as cyclical problems can evolve into structural problems.

I think faster growth would indeed improve employment conditions significantly, so let me summarize the prospects for growth in the American economy.

Since the end of the recession and the beginning of recovery in the summer of 2009, the U.S. economy has experienced average GDP growth of 2.1 percent. This is better than in many other advanced economies but is still very sluggish.

For 2013, I'm forecasting a continuation of this basic picture. I expect full-year GDP growth to be between 2 and 2 1/2 percent. I could be wrong, but I don't expect 2013 to be a breakout year.

#### **Causes of weak growth in the United States**

There are several ongoing causes of this weak growth. Households continue to either reduce or contain their debt levels. This constrains retail sales, home sales, and purchases of consumer durables that often require financing. The one major exception has been autos. The average American automobile is more than 11 years old, so new car sales, supported by credit availability, have been strong and are rising.

The financial system, the centerpiece of which is the banking system, is going through a gradual process of repair, so credit flows are constricted in comparison to the years before the recession. Bankers have also tightened credit standards in response to recent experience. At the same time, bankers continue to report that most categories of credit demand remain weak.

Business spending—including investment spending—has been restrained by a very cautious attitude on the part of decision makers. They cite uncertainties related to the federal government's fiscal situation as a primary concern along with the sovereign debt crisis here in Europe.

Productivity growth has also slowed. At the end of the recession and at the beginning of the recovery, productivity gains were substantial as employers streamlined their workforces while maintaining or growing top-line revenues.

Recently, it appears that much of the potential associated with company restructuring, headcount reduction, and cost cuts has already been exploited.

#### **Pessimism regarding long-term growth prospects**

As I said a moment ago, I hope I'm pleasantly surprised about upside prospects for the U.S. economy. There are some hopeful signs in the recent data on the U.S. economy. The housing sector—which was hammered in the recession (much like here in Spain)—appears to be coming back. We have a vibrant hydrocarbon energy sector. As I said earlier, our auto manufacturing sector is improving. And U.S. equity markets have been quite buoyant recently.

In the near term, I think growth prospects will depend on the removal of short-term obstacles to growth. Chief among these is finding workable solutions to immediate fiscal problems and to the uncertainty these challenges generate. Here in Europe, the challenge has been and continues to be one of finding the optimal balance between necessary fiscal consolidation and the conditions needed for economic stabilization and expansion. To some extent, the United States is behind Europe in tackling fiscal problems, but further along in economic recovery and stabilization.

Looking at the growth challenge more broadly, however, there is serious commentary led by Professor Robert Gordon of Northwestern University to the effect that the longer-term growth potential of the U.S. economy has shifted lower. He cites growth headwinds such as the retirement of the large baby boomer generation, lack of progress in educational attainment, and growing income inequality. Furthermore, he argues, future technological change won't deliver productivity boosts equivalent to earlier periods of rapid innovation.

Whether or not such views turn out to be true over the long term remains to be seen. Time will tell. In the medium term, I take some encouragement from emerging technologies like the industrial Internet using sensors, 3-D printing, robotics, and energy exploration and production technologies. Of course, these are some of the very technologies that Professor Gordon rejects as transformative.

These are big questions. This is a conversation that needs to occur because small changes in fundamentals underlying growth that accumulate over generations can have profound implications.

To arrive at answers, I believe you have to roll up your sleeves and get into the messy reality on the ground. It's useful, I think, to ask the simple question, "Where does employment growth come from?"

The United States, in all economic circumstances, is a very dynamic economy with continuous birth and death of enterprises. The employment the private sector produces is in a constant state of churn. Jobs are being destroyed, being created, and being redesigned. This is the practical context—both here in Europe and in the United States—for the appropriately intense focus on job creation.

#### **New and young firms: A complex dynamic**

Recently, in both the United States and Europe, including Spain, there has been increasing focus on the role of young, growth-oriented firms—so-called "gazelles"—as a major source of employment growth. In my view, some misconceptions and misrepresentations have crept into the conversation, so I want to take some care to explain our current understanding of some of the characteristics of firms that, on net, are job creators, at least in the United States.

I would argue that gazelles as a group, while unquestionably an important contributor to growth of jobs, should not be portrayed as a savior. It's important, I think, that policymakers not exaggerate any single source of job creation in pursuit of healthy employment markets.

My colleagues and I learned a number of things as we conducted research on employment and job creation.

Let me walk you through the sequence of our learning over the last couple of years. We started with the premise that small businesses, generally, are the key source of jobs. This claim was frequently made by candidates in the recent political cycle. While small firms are important, we found that it's not accurate to say small businesses are disproportionately responsible for job creation.

Almost all businesses, by number, in the United States are small. But we shouldn't confuse the number of firms with the number of jobs. In 2010, for example, businesses with 100 or more employees accounted for less than 1 percent of firms, but close to 50 percent of private-sector employment.

While today's larger, mature businesses are important as employers, they were not born large. So we looked at the age dimension of firms in explaining job creation. The premise was that it is younger firms, almost all of which are small, that disproportionately create jobs.

We found that the role of young firms in job creation is easily overstated. For instance, the claim is often made that new firms alone account for all net job creation. This is true in what you might call an accounting sense. That is, the number of jobs created by new firms about matches or exceeds the net number of jobs created by all firms.

But this fact ignores the reality that established firms that are growing create many more jobs each year than do new firms. It's just that established firms that are downsizing are responsible for destroying a lot of jobs as well. New firms haven't been around long enough to downsize. In fact, as a group, young firms between one and five years old destroy more jobs than they create because of the high failure rate.

Moreover, we found that many small firms are not established with an objective to grow and add employees. The landscape of small, young businesses is heavily populated with "mom-and-pop" businesses. They play an important social role, but are not a major source of jobs beyond the initial number of employees at establishment.

In our investigation we then looked at the argument that it is the relatively small subset of small, young, fast-growing firms—the gazelles—that drive job creation. It's clear that gazelles do contribute significantly, but it's the growth dimension, not the age or size dimension, that matters most. That is to say, fast-growing mature firms also account for a lot of job creation. And heavy emphasis on technology and bioscience industries—so popular among economic development professionals—may also be misplaced. High-growth firms emerge in a number of industries, some decidedly low tech. All in all, it's not so obvious that the likely source of high-growth firms can be identified.

The recent recession significantly constrained the growth opportunities of companies. By one definition of fast growth, there are about a third fewer fast-growing firms in the U.S. economy now compared to the mid-2000s, and they are adding about half as many jobs compared to the earlier rate. It may seem like an obvious point, but one still worth emphasizing. Innovation and entrepreneurial activity are most likely to achieve maximum impact in terms of job creation in a context of general economic growth.

What can policy, broadly speaking, do to foster growth, innovation, and job creation? At a high level, three things. First, policymakers can remove obstacles to growth—for example, uncertainty regarding the fiscal path of government, policies that discourage new business formation, and disincentives to invest. Second, and the mirror image of obstacles, is positive, pro-growth policies. Examples include investment in human capital and critical infrastructure.

And finally, there is a role for monetary policy. In my view, monetary policy can deliver appropriately favorable interest rate conditions, always in a context of low and stable inflation. Monetary policy plays a critical role in creating the most favorable conditions for other policy actions to do their work.

#### **Close**

The term "silver bullet" has become a popular way of capturing the idea of a single, straightforward solution perceived to have extreme effectiveness.

My bank's experience in trying to understand the role of small businesses, small-growth businesses, young businesses, and mature-growth businesses in job creation illustrates a key point, I think. In the pursuit of economic growth and increased employment, there is no silver bullet. Rather, the policy community should be pursuing an effective mix of policy elements (with focus in areas such as new business formation, labor rules, and regulatory efficiency, to name a few) that together catalyze a virtuous circle of innovation, growth, and employment.

Certainly, entrepreneurial risk-taking, whether by large, mature businesses or start-ups aimed at becoming growth companies, is part of the solution. You are being very well-trained here at IE for this work.

**Contact:** [Jean Tate](#) 404-498-8035

**RELATED LINKS:** [Play Speech MP3](#) • [PDF version](#) • [Dennis Lockhart's biography](#) • [Speaker's Bureau](#) • [Atlanta Fed Speeches](#)